COM/CXW/DOT/jgo 9/28/01

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Joint Application of AT&T Communications of California, Inc. (U 5002 C) and WorldCom, Inc. for the Commission to Reexamine the Recurring Costs and Prices of Unbundled Switching in Its First Annual Review of Unbundled Network Element Costs Pursuant to Ordering Paragraph 11 of D.99-11-050.	Application 01-02-024 (Filed February 21, 2001)
Application of AT&T Communications of California, Inc. (U 5002 C) and WorldCom, Inc. for the Commission to Reexamine the Recurring Costs and Prices of Unbundled Loops in Its First Annual Review of Unbundled Network Element Costs Pursuant to Ordering Paragraph 11 of D.99-11-050.	Application 01-02-035 (Filed February 28, 2001)

ASSIGNED COMMISSIONER'S AND ADMINISTRATIVE LAW JUDGE'S RULING REQUESTING FURTHER COMMENTS AND FILINGS ON MOTION FOR INTERIM RELIEF

I. Summary

This ruling sets forth dates for additional filings from parties regarding the motion for interim relief filed by AT&T Communications of California and Worldcom Inc. (hereinafter "Joint Applicants").

II. Background

On August 20, 2001,[1] Joint Applicants filed a Motion for Interim Relief, asking the undersigned Assigned Commissioner and Administrative Law Judge to order Pacific Bell Telephone Company (Pacific) to offer unbundled network element (UNE) prices for unbundled switching and unbundled loops at interim rates as set forth in the motion. Joint Applicants ask that the interim rates be subject to "true-down"[2] as a sanction against Pacific for alleged misleading statements regarding its cost studies and delays in the proceeding.

Responses to the motion were filed by Pacific, the Commission's Office of Ratepayer Advocates (ORA), The Utility Reform Network (TURN), and Tri-M Communications (Tri-M).[3] Joint Applicants filed a reply to Pacific Bell's response. On September 13, 2001, the ALJ held a prehearing conference to ask questions regarding the motion and responses to it.

III. Discussion

We are considering granting Joint Applicants' motion for interim relief in part, but we will require additional filings from parties on the exact amount and nature of the interim relief proposals. Specifically, we will allow Pacific a further opportunity to comment substantively on the proposed amount of any interim reduction in the price for the unbundled loop UNE. With regard to the

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[1] All dates are 2001 unless otherwise noted.

[2] Essentially, a "true-down" means that if final rates are lower than interim rates, Pacific Bell should provide refunds to those who purchase unbundled loops or switching UNEs, but if rates are ultimately higher than any interim rate, buyers of these UNEs would not owe any additional payment.

[3] Along with its comments, Tri-M filed a petition for leave to enter an appearance in this proceeding which we grant herein.

unbundled switching UNE, we ask Joint Applicants to amend their request as explained further in this ruling. We will then allow Pacific to comment on any amended interim relief request for unbundled switching.

a. Interim Relief is Justified

Joint Applicants state in their motion, and in statements at the prehearing conference, that interim relief is justified at this juncture in the proceeding because of alleged flaws in Pacific's August 15th cost filing. In previous rulings in this docket, we limited the scope of this proceeding to an examination of Pacific's updated cost studies for unbundled loops and unbundled switching. In response to a request by Joint Applicants to allow competing cost models, we set forth three criteria for Pacific's model and cost studies and we left open the question of whether to allow the introduction of competing models if we found Pacific's filing insufficient. Specifically, we required that Pacific's cost models and cost studies must allow parties to:

1) Reasonably understand how costs are derived for unbundled loops and switching,

2) Generally replicate Pacific's calculations; and

3) Propose changes in inputs and assumptions in order to modify the costs produced by these models.

Following a technical workshop on August 9, 2001, Joint Applicants, ORA, and TURN filed comments stating that Pacific's cost models and cost studies did not meet these three criteria. The parties explained that Pacific's "starting point" for its filings in this docket appeared to merely adjust the outputs of the models used to develop costs and prices in the prior OANAD

proceeding.[4] The workshop and comments identified that several of the prior models are no longer available and it is not possible to re-run them with new inputs. Pacific does not dispute that its filing involves adjustments to the outputs of the prior OANAD model and that it is not possible to provide the previously adopted model with new inputs.

It does not appear that Pacific's filing meets our previously established criteria. Specifically, Pacific uses endpoints from OANAD and adjusts them rather than actually providing the former model with new inputs. The filing fails the first and second criteria because parties and staff may find it difficult to understand and replicate the calculations and the inputs of the prior OANAD models without an actual re-run of these models. Pacific itself is not replicating these prior models since it is not performing new runs of the SCIS model for switching investment, the Cost Proxy Model for loop investment, or other mainframe models used to calculate expenses and support investments. Finally, Pacific's filing fails the third criteria because parties cannot input their own numbers to Pacific's models and re-run them. Thus, it appears quite difficult for parties to modify assumptions from the prior OANAD models. Without the ability to modify assumptions and re-run the models, it is unclear how the evidence and assumptions that formed the basis for Joint Applicant's initial showing to open this proceeding can actually be tested, modified, and examined.

Pacific defends its filing by stating that the prior OANAD models are not needed because a "proportionate change to an input to the OANAD cost studies results in the same proportionate change to that input's component of the

[4] See Decision (D.) 98-02-106 and D.99-11-050.

output." (See Pacific's Reply to Workshop Comments, 8/23/01, Appendix A, pg. 1.) The problem with this argument is that without the ability to examine the actual model, it is difficult for parties or commission staff to ascertain what Pacific defines as "the input's component of the output." Parties and Commission staff cannot assume relationships in the model are linear without the ability to examine and run the model.

We are concerned that if we were to proceed only with the filing presented by Pacific, any resulting UNE prices might not be cost-based as required by Section 252 of the Telecommunications Act of 1996. We will have less confidence in the results of our efforts without the ability to run an actual model and test inputs and assumptions. It is not clear if Pacific can amend its filing to overcome the problems identified. Because Pacific's filing does not currently meet our criteria, we are faced with the option of allowing Joint Applicants and other parties to file competing cost models. Indeed, Joint Applicants, along with their motion, filed the HAI Model 5.2a (HAI) and testimony in support of the analysis contained in the HAI model. If we were to consider this competing model and afford Pacific and commission staff adequate time to examine the additional material, a substantial delay of many months in the case from the initial schedule would certainly result. Although parties were willing to consider this option and attempt to have hearings on the same initial schedule, they were unable to agree on a schedule. Further, we do not think they have proposed a realistic timeline.

Because of the substantial delay in the case that would be caused by either allowing Pacific to amend its filing or by considering competing filings, we are persuaded to grant some form of interim relief. As noted in our June 14th Scoping Memo, Joint Applicants provided an adequate initial showing to

support a reasonable presumption that costs for unbundled loops and unbundled switching had declined over currently adopted costs. Based on that initial showing, we decided to move forward to set new UNE rates for loops and switching. Pacific's cost update filing, however, does not allow Joint Applicants to adequately test many of the factors that they argue should lead to lower UNE costs such as decreases in switching investment costs, line growth, merger savings from SBC's merger with Pacific Telesis and Ameritech, Project Pronto deployment, and Digital Loop Carrier (DLC) equipment costs. Although Pacific disputes the effects of some of these factors on UNE rates, it has not presented us with a model that parties and staff can use to test various assumptions regarding these factors. We consider it likely that at least some of these factors will lead to decreases in UNE rates for loops and switching. Nevertheless, Pacific's current filing leaves us without the ability to test or examine the effect of documented changes such as line growth, mergers, and technology deployment.

Any significant delay in this proceeding caused by the need to consider a competing model could present a barrier to competition. Joint Applicants argue that a "price squeeze" now exists because a competitive local carrier competing for residential and single-line business local exchange service must pay Pacific for the necessary UNEs to recreate these services, including UNEs for such "monopoly building blocks" as loops and switching, at a minimum price that exceeds Pacific's current retail rates for these services. Joint Applicants argue that this alleged price squeeze represents an insurmountable barrier to meaningful competition in local exchange markets. Pacific responds that Joint Applicants have not shown an "emergency" that requires interim rate relief. Without deciding whether or not a price squeeze exists, we have already found that Joint Applicants' have made a *prima facie* case that current rates are not cost-

based. If UNE rates for monopoly building blocks such as loops and switching are not cost-based, this could create a barrier to competition because it would artificially enlarge any disparities that currently exist between Pacific's retail rates and the rates competitors pay for monopoly building blocks. Thus, we find that based on the *prima facie* showing of non-cost based UNE rates, there is an immediate and substantial barrier to consumers receiving the benefits of competition in local exchange markets as envisioned by the 1996 Act. These potential benefits include lower prices, increased choice, and better service.

Given these factors, we are unwilling to leave the current UNE prices for unbundled loops and unbundled switching in place while we adjust the schedule to consider competing cost models. We believe the *prima facie* evidence of decreased network costs, the immediate and real threat to competition posed by potentially non-cost based rates, and the unexpected delay caused by the deficiencies in Pacific's filing warrant interim relief, pending a full proceeding on the competing cost models.

Pacific argues against the motion for interim relief, contending there is no justification for a deviation from the prior schedule and that due process requires the Commission to hold a hearing before setting any interim rates. We disagree with Pacific on both of these arguments. Interim rates are justified for the reasons stated above and because, based on our review of Pacific's August 15th filing, we do not believe that the schedule we initially envisioned for this proceeding can reasonably be met. When we limited the scope of this proceeding to only one cost model from Pacific, we expected that the filing would involve the actual models used in the prior OANAD proceeding and we were unaware that several of these models are not currently available. Further, the California Supreme Court has found that Commission does not need to

premise interim relief on an emergency but can grant interim rate increases, subject to refund, when those increases are reflected in a balancing account and sufficient justification for the interim relief has been presented. (*TURN v. CPUC*, 44 Cal. 3d 870, 879 (1988); see also *Re Southern California Edison Company*, 28 CPUC 2d 203, 212 and 219 (D.88-05-074.) We also agree with Joint Applicants that the Commission can set interim rates, without an evidentiary hearing. We do not find it a violation of Pub. Util. §728 to set an interim rate without a hearing, because we will take further written comment on the amount of interim relief and the Commission is not determining or fixing a final rate by setting an interim one subject to a true-up. The Commission will "fix" final rates only after further proceedings and any interim rates will be subject to adjustment. After we consider the appropriate amount of interim relief to grant, we intend to continue immediately our consideration of final prices for unbundled loops and unbundled switching in the applications before the Commission.

Pacific also criticizes the HAI model that Joint Applicants use to support the proposed interim rates. These criticisms can be considered in the course of the proceeding as we examine final rates and do not impact our decision to offer interim relief. Any grant of interim relief is not intended to prejudge any of the disputed issues regarding the merits of the HAI model. We will consider the interim relief request not based on the results of the HAI model, but based on the preliminary evidence in the initial showing of Joint Applicants that demonstrates that underlying costs of loops and switching have decreased.

Pacific provides further defense of its August 15th cost study filing in its September 19th testimony served on the parties to this proceeding. Notwithstanding the contents of this testimony, or the testimony presented by other parties, we have examined the August 15th filing and, with the assistance of

Commission staff, independently reached the conclusion that the filing does not meet the model criteria we established in our earlier ruling. We can consider the positions and statements in the testimony in the further course of this proceeding, after we set interim rates. This ruling is not intended to prejudge any of the positions or statements presented in Pacific's testimony since it has not been cross-examined or received into evidence. The same is true of testimony presented by other parties. This ruling merely decides that interim relief is appropriate at this time given the delays looming in the proceeding based on the shortcomings of Pacific's cost filing and the need to admit competing models. This ruling further allows Pacific to file comments on the appropriate amount of interim relief.

We acknowledge that we previously denied ORA's request for interim relief in June because we did not find the record sufficient at that time to warrant an immediate 20% reduction in UNE rates and we stated an unwillingness to inject uncertainty into the market for those competitors who purchase UNEs. Although only three months have passed, we are now willing to reverse this position because of the extended delays that are looming in this proceeding due to the deficiencies noted in Pacific's filing and the need to consider alternative models presented by other parties.

b. Unbundled Loop Proposal

With regard to unbundled loops, Joint Applicants have proposed an interim reduction of 36% in the UNE loop rate. We will allow Pacific to comment on the amount of the interim reduction proposed by Joint Applicants. Pacific should focus its comments on whether a reduction of 36% from current unbundled loop costs is supportable based on Pacific's costs and the cost drivers noted by Joint Applicants, namely line growth and DLC equipment costs. Pacific

should avoid legal or due process arguments on the notion of interim relief itself. Pacific shall file its comments no later than October 19th, and we will allow replies to Pacific's comments by Joint Applicants or other parties no later than October 30th.

c. Unbundled Switching Proposal

With regard to unbundled switching, Joint Applicants have proposed that we require Pacific to set rates equivalent to either of two proposals made by Pacific's affiliate, SBC-Ameritech, in Illinois. Both of these options entail a very different rate structure than was adopted for Pacific's unbundled switching UNEs in this Commission's OANAD decisions. The Illinois proposals involve a two-part pricing structure, including both a monthly flat rate per-port and a minute-of-use rate. Both proposals include access to all vertical features at no additional charge. Current California unbundled switching prices involve a port charge, separate charges for each feature, set-up charges per call and usage charges per minute-of-use.

Joint Applicants contend that the Illinois switching rates are justified for an interim proposal because Pacific has stated it can obtain prices for switching equipment in California generally the same or more favorable than the prices to SBC affiliates in other states, including Illinois. (Reporter's Transcript (RT) PHC-2, at 127, 128.) Joint Applicants also contend that an Illinois switching rate is valid based on comparison of line density per switch between Illinois and California. (RT PHC-2, at 129.) Moreover, Joint Applicants argue for a new price structure for California similar to the Illinois price structure and have presented testimony in support of their motion on several price structure issues that the Commission may want to consider over the course of this proceeding. These price structure issues involve changes from what the Commission adopted in

previous OANAD orders based on alleged new evidence regarding port and usage costs, vertical feature costs, and the "life cycle" concept of switch investment.

In reply, Pacific argues that price structure and other portions of the Illinois switching rate proposal run counter to decisions in OANAD, particularly with regard to setup and duration charges in California, fill factors, treatment of shared and common costs, and depreciation. (RT PHC-2, at 84 and 132-134.)

We are concerned that the proposed interim rates from Illinois differ dramatically in price structure from our current California rates. While we are open to considering changes in price structure for the unbundled switching UNE in the final outcome of this proceeding, we do not think it is appropriate to base an interim rate on a dramatically different price structure that has not been fully litigated as it pertains to Pacific's costs in California. Therefore, we think it makes more sense to set an interim rate based on the existing price structure. Any long-term price structure changes can be fully litigated based on evidence provided by the parties. If we were to take the time now to fully consider the evidence and policy issues surrounding the idea of a differing price structure, that would defeat the purpose of interim relief. Therefore, if Joint Applicants wish to pursue the idea of interim relief for the unbundled switching UNE, they should reformulate their request to entail a percentage reduction from current unbundled switching rates under the current California price structure, similar to the methodology employed for the proposed interim rate for unbundled loops.

Joint Applicants should file any amended interim relief proposal no later than October 15th. Pacific may comment on this amended interim relief proposal by October 30th and other parties may reply to Pacific's comments no later than November 9th.

d. Any Interim Relief Subject to True-Up

In any order granting interim relief, we will not recommend approval of Joint Applicant's request for a "true-down." The Commission is required by the Section 252 to set just and reasonable rates for network elements based on the cost of providing the network element.[5] If the Commission set interim rates that were not adjustable, and those rates were later found to be inaccurate, the Commission would have violated this criteria. Therefore, we cannot grant Joint Applicant's request for a "true-down." We will only consider granting interim relief subject to adjustment either up or down once final rates are determined so that Pacific and other parties can be made whole if final rates differ from any interim relief.

IV. Summary of Filing Dates

This ruling adopts the following schedule for further comment on Joint Applicants' motion for interim relief:

<u>Unbundled Loop Interim Proposal</u>	
Comments by Pacific:	October 19
Reply Comments:	October 30
<u>Unbundled Switching Interim Proposal</u>	
Amended Proposal by Joint Applicants:	October 15
Comments by Pacific:	October 30
Reply Comments:	November 9

[5] 47 U.S.C. § 252(d)(1).

V. Schedule for the Remainder of the Proceeding

While we consider the motion for interim relief, we will set aside the schedule for this proceeding that was described in our June 14th scoping memo. We envision that following the submittal of comments and reply comments on the interim relief proposals as set forth in this ruling, we will draft an order for the Commission's agenda setting forth the amount of interim relief to be granted. We will endeavor to place a draft order on the Commission's agenda for consideration by the end of this year.

Given our current criticisms of Pacific's August 15th filing, we will allow Joint Applicants to introduce the HAI model that accompanied the motion for interim relief once we return to the matter of reexamining final rates for unbundled loops and unbundled switching. We expect to issue a ruling with a revised schedule and scope for this proceeding around the same time that we issue any draft decision on the interim relief request. The new schedule will allow adequate time for discovery and hearings, if needed, on the HAI model as well as on Pacific's current filing.

VI. ISDN/xDSL Capable Loops

At the July 9 prehearing conference, Rhythms Links requested clarification that Pacific's cost studies would include ISDN/xDSL capable loops. In a July 11 ruling, we agreed that Pacific's cost studies should include costs for these loops. Pacific subsequently objected to performing cost studies for ISDN/xDSL capable loops. Rhythms Links then clarified that it was simply requesting that any cost and price set in this proceeding for voice grade loops should also apply to ISDN/xDSL capable loops. Pacific does not object to this. Therefore, we clarify that we are not requiring Pacific to file additional cost studies for ISDN/xDSL loops, but any interim or permanent change in cost to voice grade UNE loops

resulting from this proceeding should be applied in setting the price of ISDN/xDSL capable loops.

IT IS RULED that:

1. Pacific should file comments and parties may file reply comments on the proposed interim rate for unbundled loops as set forth herein.

2. Joint Applicants should revise their proposal for an interim rate for unbundled switching as set forth in this ruling no later than October 15.

3. Pacific should file comments on the amended interim rate proposal for unbundled switching and parties may reply to these comments as set forth herein.

4. The petition for leave to intervene filed by Tri-M is granted.

5. Any interim or permanent change in cost to voice grade UNE loops resulting from this proceeding should be applied in setting the price of ISDN/xDSL capable loops.

6. The schedule for this proceeding as set forth in the June 14th Scoping Memo is set aside pending further ruling after consideration of the Joint Applicant's motion for interim relief.

Dated September 28, 2001, at San Francisco, California.

/S/ CARL WOOD
Carl Wood
Assigned Commissioner

/s/ DOROTHY J. DUDA
Dorothy J. Duda
Administrative Law Judge

CERTIFICATE OF SERVICE

I certify that I have by mail this day served a true copy of the original attached Assigned Commissioner's and Administrative Law Judge's Ruling Requesting Further Comments and Filings on Motion for Interim Relief on all parties of record in this proceeding or their attorneys of record.

Dated September 28, 2001, at San Francisco, California.

/s/ JACQUELINE GORZOCH
Jacqueline Gorzoch

N O T I C E

Parties should notify the Process Office, Public Utilities Commission, 505 Van Ness Avenue, Room 2000, San Francisco, CA 94102, of any change of address to insure that they continue to receive documents. You must indicate the proceeding number on the service list on which your name appears.

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